



CHICAGO MERCANTILE EXCHANGE HOLDINGS INC.

MEMORANDUM

TO: Class B Shareholders

FROM: Chicago Mercantile Exchange Holdings Inc.

RE: Basis Allocation Methods

DATE: February 24, 2003

In the past few years, the Chicago Mercantile Exchange has undergone two major transactions that altered its organizational structure. On November 13, 2000, the old Chicago Mercantile Exchange (“Old CME”) executed a series of transactions to convert from an Illinois not-for-profit membership corporation to a Delaware for-profit stock corporation (the “Demutualization”). In the Demutualization, the members of Old CME exchanged their membership interests in Old CME for Class A and Class B common stock of the new Delaware corporation (“New CME”). The New CME Class A common stock conveyed only equity interests in New CME, while the New CME Class B common stock carried both equity (Class A equivalent) interests and non-equity membership rights in New CME.

Then on December 3, 2001, New CME executed a second series of transactions to adopt a holding company structure (the “Merger”). In the Merger, the shareholders of New CME exchanged their New CME Class A common stock and the equity component of their New CME Class B common stock for Class A and Class B common stock of Chicago Mercantile Exchange Holdings Inc. (“CME Holdings”) and retained their membership rights in New CME (the “New Membership Interests”).

As a consequence of the Demutualization and the Merger, therefore, each Old CME membership interest is now represented by CME Holdings Class A and Class B common shares and a New Membership Interest. CME Holdings has received inquiries from a number of shareholders regarding how they should determine their basis in their CME Holdings Class A and Class B shares and New Membership Interests for United States federal income tax purposes.

The Demutualization and the Merger were treated as tax free transactions. The federal income tax laws are clear that, because of this tax free treatment, an Old CME member's basis in his Old CME membership interest must be allocated first among the New CME Class A and Class B shares received in the Demutualization according to the relative fair market values of such shares on November 13, 2000, and then among the CME Holdings Class A and Class B shares received and the New Membership Interest retained in the Merger according to the relative fair market values of such shares and interest on December 3, 2001. As a practical matter, because the CME Holdings Class B shares and the New Membership Interests can only be traded together, a shareholder would only need to allocate the basis of his New CME Class B share among the CME Holdings Class A shares, on the one hand, and the CME Holdings Class B share and the New Membership Interest as a combined unit, on the other. The tax laws are not clear, however, regarding how to determine the fair market values of such shares and interests in the absence of actual trading on those dates.

No trading of the above-described shares and interests occurred on November 13, 2000 or December 3, 2001. Basis allocation is further complicated by the "bundling" of equity interests and non-equity membership rights in a single instrument with the New CME Class B common stock received in the Demutualization. Consequently, the appropriate methodology for allocating basis as described above is not clearly provided by the tax laws but rather involves a mixed question of fact and law. The attached memorandum, which is designed for your tax advisor, provides a discussion of allocation alternatives. The memorandum is necessarily lengthy given the complexity of the Demutualization and Merger transactions. Shareholders of CME Holdings who sell or anticipate selling their CME Holdings Class A or Class B shares should consult their tax advisors regarding the allocation of tax basis among those shares and their New Membership Interests.



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In response to inquiries from a number of shareholders, Chicago Mercantile Exchange Holdings Inc. (“CME Holdings”) is providing this memorandum to Class B shareholders describing several methods Class B shareholders could use to determine their basis in their CME Holdings Class A shares and Class B shares and membership interests for United States federal income tax purposes. This memorandum explains how a shareholder of CME Holdings could allocate the tax basis of an old Chicago Mercantile Exchange (“Old CME”) membership interest among the various shares and interests received in the conversion of Old CME to a stock corporation and the subsequent adoption of a holding company structure. There are a number of other methods a shareholder could also use to determine his tax basis and CME Holdings is not advocating any particular alternative. Different methods of allocation could yield different tax results.

This discussion is provided for informational purposes only and does not represent formal tax advice. Shareholders of CME Holdings who sell or anticipate selling their CME Holdings Class A or Class B shares should consult their own tax advisers.

On November 13, 2000, Old CME executed a series of transactions to convert from an Illinois not-for-profit membership corporation to a Delaware for-profit stock corporation (the “Demutualization”). Participation in Old CME was represented by membership interests (the “Old Membership Interests”) that included both equity interests and non-equity membership rights. In the Demutualization, the members of Old CME exchanged their Old Membership Interests for Class A and Class B common stock of the new Delaware corporation (“New CME”). The New CME Class A common stock conveyed only equity interests in New CME, while the New CME Class B common stock carried both equity (Class A equivalent) interests and non-equity membership rights in New CME

Old CME maintained four separate membership categories: Chicago Mercantile Exchange members (“CME Members”); International Monetary Market members (“IMM Members”); Index and Option Market members (“IOM Members”); and Growth and Emerging Market members (“GEM Members”). In the Demutualization, holders of these memberships exchanged their memberships for Class A and Class B shares of New CME as follows:

- Each CME Member received 16,200 Class A shares and one Series B-1 share of New CME common stock.
- Each IMM Member received 10,800 Class A shares and one Series B-2 share of New CME common stock.
- Each IOM Member received 5,400 Class A shares and one Series B-3 share of New CME common stock.
- Each GEM Member received no Class A shares and one Series B-4 share of New CME common stock.

Because the GEM Members received only a single New CME Series B-4 share in the Demutualization, no basis allocation is necessary for such members as a consequence of that transaction. Such member’s basis in his single New CME Series B-4 share would be equal to his basis in the Old Membership Interest surrendered therefor.

On December 3, 2001, New CME executed a second series of transactions to adopt a holding company structure (the “Merger”). As a consequence of the Merger, New CME became a wholly-owned subsidiary of CME Holdings. The shareholders of New CME retained the non-equity membership right component of the New CME Class B common stock (the “New Membership Interests”) but exchanged their New CME Class A common stock for CME Holdings Class A common stock and also exchanged the equity portion of their New CME Class B common stock for CME Holdings Class A and Class B common stock.

Immediately prior to the Merger, and to facilitate the share exchange undertaken in connection with that transaction, New CME executed a four-to-one reverse stock split of the New CME Class A and Class B shares. Then, in the Merger, New CME’s shareholders exchanged their New CME Class A and Class B shares for CME Holdings Class A and Class B shares as follows:¹

- Each share of New CME Class A common stock was converted into four shares of CME Holdings Class A common stock.
- Each share of New CME Series B-1 common stock was converted into 1779 shares of CME Holdings Class A common stock and one share of CME Holdings Class B-1 common stock.

¹ There were actually four classes of CME Holdings Class A stock issued in the merger in exchange for New CME Class A and Class B shares. These four classes were identical except for certain transfer restrictions that expired at different intervals of time depending upon the class. To simplify this analysis, the four classes of CME Holdings Class A common stock have been aggregated. In the event a shareholder needed to allocate basis among the different classes of Class A common stock, a straight pro-rata allocation of aggregate Class A common stock basis would be reasonable.

- Each share of New CME Series B-2 common stock was converted into 1199 shares of CME Holdings Class A common stock and one share of CME Holdings Class B-2 common stock.
- Each share of New CME Series B-3 common stock was converted into 599 shares of CME Holdings Class A common stock and one share of CME Holdings Class B-3 common stock.
- Each share of New CME Series B-4 common stock was converted into 99 shares of CME Holdings Class A common stock, and one share of CME Holdings Class B-4 common stock.
- The non-equity membership rights associated with the New CME Class B common stock were not affected by the Merger but rather were retained by the holders of those shares and preserved by New CME as the New Membership Interests.

Theoretically, the basis of the New CME Class A shares surrendered in the Merger would carry to the CME Holdings Class A shares received in exchange therefor, while the basis of the New CME Class B share surrendered in the Merger would be allocated among the CME Holdings Class A shares and the CME Holdings Class B share received in exchange therefor and the New Membership Interest retained in the Merger. As a practical matter, however, because the CME Holdings Class B shares and the New Membership Interests can only be traded together, a New CME shareholder only needs to allocate the basis of his New CME Class B shares between the CME Holdings Class A shares, on the one hand, and the CME Holdings Class B share and the New Membership Interest as a combined unit (the “CME Holdings B Share Unit”), on the other.

As a consequence of the Demutualization and the Merger, each Old Membership Interest is now represented by Class A and Class B common shares of CME Holdings and a New Membership Interest. For U.S. federal income tax purposes, the Demutualization and Merger were treated as tax free transactions. Therefore, the aggregate basis of a member’s CME Holdings Class A and Class B shares and New Membership Interest is the same as such member’s basis in his Old Membership Interest. That aggregate basis must be allocated among the two classes of stock and the following paragraphs describe this process.

Generally, where a single class of stock (or the membership equivalent thereof) is exchanged for two or more classes of stock, the basis of the single class must be allocated among the classes of stock received in exchange in proportion to their relative fair market values as of the date of the exchange (the “Valuation Date”). Because the Demutualization and the Merger were separate transactions, a member should (1) allocate the basis in his Old Membership Interest between the New CME Class A and Class B shares received in the Demutualization according to their relative fair market values on the Demutualization Valuation Date, (2) carry the basis in the New CME Class A shares received in the Demutualization to the CME Holdings Class A shares received in exchange therefor in the Merger, and (3) allocate the basis in the New CME Class B shares between the CME Holdings Class A shares received in exchange therefor in the Merger and the CME Holdings B Share Unit, again in proportion to their relative fair market values on the Merger Valuation Date.

The tax laws do not define “fair market value” for basis allocation purposes. Taxpayers often use the methods employed by the estate and gift tax regulations to establish fair market value for this purpose, but other reasonable measures or methodologies may also be defensible. The estate and gift tax regulations generally rely upon actual sales to evaluate fair market value. CME’s Shareholder Relations and Membership Services Department maintains records of bids, offers, and sale prices for the various interests.² The trades of the various shares and interests do not occur with sufficient frequency to make the application of the estate and gift tax regulations wholly straight forward. Nevertheless, the existing trading information appears adequate to devise a reasonable approach to estimating fair market value, and thus allocating basis, using the guidance of the estate and gift tax regulations.

Because the transferability of the New CME Class A shares and the CME Holdings Class A shares alone was restricted on the respective Demutualization and Merger Valuation Dates, there is no sales data for assessing fair market value of such shares on those dates separately from the other interests received in those transactions. A member could extrapolate the fair market values of the various shares and interests on the respective Valuation Dates, however, through the following series of steps. Starting with the Demutualization, a member could determine the Valuation Date fair market values of the New CME Class A and Class B shares by (1) setting the fair market value of the New CME Class A and Class B shares as a unit (the “New CME Bundled Unit”), then (2) setting the fair market value of a New CME Class B share alone, and finally (3) subtracting the fair market value of the New CME Class B share from that for the New CME Bundled Unit to derive the fair market value for the New CME Class A shares. A member could then follow a similar series of steps to determine the Valuation Date fair market values of the CME Holdings shares and interests received in the Merger. Although the fair market values of such interests can be computed in many ways, Exhibit A to this memorandum offers a few examples of this allocation approach using data from the Shareholder Relations and Membership Services Department’s records.

The above discussion and the examples in Exhibit A represent only a few alternatives that a shareholder of CME Holdings could use to allocate his or her basis in his or her Old Membership Interest among his or her CME Holdings Class A and Class B shares and New Membership Interest. Other basis allocation approaches could yield different tax results depending upon individual circumstances. **Shareholders of CME Holdings who sell or anticipate selling their CME Holdings Class A or Class B shares should consult their own tax advisers.**

² Exhibits B and C to this memorandum summarize relevant sales information derived from these records.

EXHIBIT A: ALLOCATION COMPUTATION EXAMPLES

The following examples use sales data for Old Membership Interests and New CME Series B-1 shares³ to illustrate the steps outlined in the attached memorandum for allocating the tax basis of an Old Membership Interest between the New CME Class A and Class B shares received in exchange therefor in the Demutualization.⁴

Table 1: CME Member Demutualization Sales Data

Sale Dates	Trading Days from Valuation Date ⁵	Sale Price
Last Old Membership Interest Sale: 11/10/00	1	\$430,000
First New CME Bundled Unit (Series B-1) Sale: 12/22/00	27	\$525,000
First New CME Series B-1 Sale: 1/10/01	n/a	\$188,000

Weighted Average Method

Starting with the Demutualization and following the steps outlined in the memorandum, a member could use a weighted average approach to determine the Valuation Date fair market values of the New CME Class A and Class B shares as follows:

1. Set the fair market value of the New CME Bundled Unit at the weighted average of the last pre-Demutualization sale price for an Old Membership Interest and the first post-Demutualization sale price for the New CME Bundled Unit⁶.

³ As indicated in the memorandum, the Class B shares issued by New CME in connection with the Demutualization were issued in four series: Series B-1 for CME Members, Series B-2 for IMM Members, Series B-3 for IOM Members, and Series B-4 for GEM Members. The Class B shares issued by CME Holdings in exchange for the New CME Class B shares were similarly divided into four separate classes: Class B-1 for New CME Series B-1, Class B-2 for New CME Series B-2, Class B-3 for New CME Series B-3, and Class B-4 for New CME Series B-4.

⁴ Exhibits B and C summarize relevant sales information derived from Shareholder Relations and Membership Services Department records for CME, IMM, IOM, and GEM membership interests and the corresponding New CME Series B shares and New CME Bundled Units. There is no corresponding New CME Bundled Unit for GEM membership interests.

⁵ In calculating the number of trading days between the Demutualization and the sales closest to that date, we have assumed that Saturdays, Sundays, and the Thursday and Friday traditionally recognized as the Thanksgiving holiday were not trading days, and that all other days during that period were trading days.

⁶ There were no sales of interests on the respective Valuation Dates for the Demutualization and Merger, but sales or matched bid and offer exchanges in all classes occurred within a few weeks before and after both the Demutualization and the Merger. In such cases, the relevant estate and gift tax regulations determine the fair market value of the interests sold by taking a weighted average of such sales on the nearest date before and the nearest date after the Valuation Date, with the average weighted inversely by the respective numbers of trading days between the selling dates and the Valuation Date. This computation is demonstrated immediately below Table 1.

Using the above sales data, the weighted average of the sales on the nearest date before and the nearest date after the Valuation Date, and thus the fair market value on the Valuation Date, of the New CME Bundled Unit can be calculated.

$$(27 \times \$430,000) + (1 \times \$525,000) / 28 = \$433,393 \text{ FMV New CME Bundled Unit}$$

2. Set the fair market value of a New CME Class B share at the first sale price of such a share alone, \$188,000 using the above sales data.
3. The Valuation Date fair market value of the 16,200 New CME Class A common shares received by a CME Member, \$245,393, can then be extrapolated by subtracting the first sale price of a New CME Class B share of \$188,000 from the weighted average fair market value calculated for the New CME Bundled Unit of \$433,393.

Assuming a hypothetical member that held his Old Membership Interest with an adjusted tax basis of \$100,000, the allocation of that basis between the New CME Class A and Series B-1 shares received by such member in the Demutualization could then be determined.

Table 2: Allocation of Basis Using Weighted Average Method Fair Market Value

	FMV @ Valuation Date	% of Total FMV	Basis @ Valuation Date
16,200 New CME Class A	\$245,393	56.6%	\$56,600
One New CME Series B-1	\$188,000	43.4%	\$43,400
Total	\$433,393		\$100,000

First Sale Method

Although the estate and gift tax regulations call for the use of a weighted average of the sale prices before and after the Valuation Date, other approaches to determining the fair market value of the New CME Class A and Class B shares on the Valuation Date may be reasonably applied. For example, because there is no pre-Demutualization equivalent to the New CME Series B-1 sale, it is arguable in this case that only the first post-Demutualization New CME Bundled Unit sale price of \$525,000 should be used to represent the Valuation Date fair market value of a New CME Bundled Unit. The Valuation Date fair market value of the 16,200 New CME Class A common shares received by a CME Member can then be extrapolated by subtracting the first sale price of a New CME Class B share of \$188,000 from that first post-Demutualization New CME Bundled Unit sale price.

$$\$525,000 - \$188,000 = \$ 337,000 \text{ FMV 16,200 New CME Class A shares}$$

Again employing the hypothetical CME Member holding an Old Membership Interest with an adjusted tax basis of \$100,000, such basis could then be allocated between the New CME Class A and Series B-1 shares.

Table 3: Allocation of Basis Using First Sale Method Fair Market Value

	FMV @ Valuation Date	% of Total FMV	Basis @ Valuation Date
16,200 New CME Class A	\$337,000	64.2%	\$64,200
One New CME Series B-1	\$188,000	35.8%	\$35,800
Total	\$525,000		\$100,000

Comparative Method

Another way to compensate for the lack of a pre-Demutualization equivalent to the New CME Series B-1 sale would be to compare the first post-Demutualization New CME Bundled Unit sale with the first post-Demutualization New CME Series B-1 sale, then apply the resulting percentage to the weighted average of the New CME Bundled Unit and the Old Membership Interest sale prices to calculate the Valuation Date fair market value of a New CME Series B-1 share, and finally derive the fair market value of 16,200 New CME Class A shares on the valuation date.

$$\$188,000 / \$525,000 \times \$433,393 = \$155,196 \text{ FMV One New CME Series B-1 share}$$

$$\$433,393 - \$155,196 = \$278,197 \text{ FMV 16,200 New CME Class A shares}$$

Using these Valuation Date fair market values, the hypothetical CME Member's \$100,000 basis in his or her Old Membership Interest could be allocated between the New CME Class A shares and Series B-1 share received in exchange therefor.

Table 4: Allocation of Basis Using Comparative Method Fair Market Value

	FMV @ Valuation Date	% of Total FMV	Basis @ Valuation Date
16,200 New CME Class A	\$278,197	64.2%	\$64,200
One New CME Series B-1	\$155,196	35.8%	\$35,800
Total	\$433,393		\$100,000

Once basis has been allocated to reflect the Demutualization, a CME Holdings shareholder could use the same steps and methods to extrapolate fair market values for and allocate basis among the relevant interests received in the Merger as well:

- determine the Valuation Date fair market value for the CME Holdings Class A and Class B shares received and the New Membership Interest retained in the Merger (the "CME Holdings Bundled Unit"), using either the weighted average calculation or merely the first post-Merger sale price;
- determine the Valuation Date fair market value for the CME Holdings B Share Unit, using either the first post-Merger sale price or the comparative approach;

- determine the Valuation Date fair market value for all CME Holdings Class A shares by subtracting the fair market value of the CME Holdings B Share Unit from the fair market value of the CME Holdings Bundled Unit;
- allocate basis between all CME Holdings Class A shares and the CME Holdings B Share Unit according to their relative fair market values;
- subtract the carryover basis of the CME Holdings Class A shares received in exchange for the New CME Class A shares to determine the basis for the CME Holdings Class A shares received in exchange for the New CME Class B shares.

Because the CME Holdings Class A shares all can be traced to a single Old Membership Interest, a shareholder could argue alternatively that all of his or her CME Holdings Class A shares should carry the same basis rather than being regarded as two separate blocks, and thus that the last step listed above is not necessary.

The above examples illustrate only a few alternatives that a shareholder of CME Holdings could use to allocate his or her basis in his or her Old Membership Interest among his or her CME Holdings Class A and Class B shares and New Membership Interest. Other basis allocation approaches could yield different tax results depending upon individual circumstances. **Shareholders of CME Holdings who sell or anticipate selling their CME Holdings Class A or Class B shares should consult their own tax advisers.**

EXHIBIT B: DEMUTUALIZATION SALES DATA

	Sale Date	Sale Price
CME Members		
Last Old Membership Interest Sale*	11/10/00	\$430,000
First New CME Series B-1 Bundled Unit Sale	12/22/00	\$525,000
First New CME Series B-1 Share Sale	01/10/01	\$188,000
IMM Members		
Last Old Membership Interest Sale	11/10/00	\$390,000
First New CME Series B-2 Bundled Unit Sale*	12/28/00	\$428,000
First New CME Series B-2 Share Sale	01/05/01	\$185,000
IOM Members		
Last Old Membership Interest Sale	11/10/00	\$230,000
First New CME Series B-3 Bundled Unit Sale*	12/19/00	\$244,000
First New CME Series B-3 Share Sale	12/14/00	\$112,000
GEM Members**		
Last Old Membership Interest Sale	11/10/00	\$20,000
First New CME Series B-4 Share Sale	12/22/00	\$12,500

* Indicates matched bid and offer sales.

** GEM members did not receive New CME Class A shares in the demutualization, so there is no Bundled Unit corresponding to New CME Series B-4 shares.

EXHIBIT C: MERGER SALES DATA

	Sale Date	Sale Price
Class B-1 (CME Members)		
Last New CME Bundled Unit Sale	11/30/01	\$750,000
First CME Holdings Class B-1 Bundled Unit Sale	12/20/01	\$756,000
First CME Holdings Class B-1 Share Unit Sale*	12/14/01	\$360,000
Class B-2 (IMM Members)		
Last New CME Bundled Unit Sale	11/30/01	\$589,500
First CME Holdings Class B-2 Bundled Unit Sale	12/11/01	\$600,000
First CME Holdings Class B-2 Share Unit Sale	12/11/01	\$342,000
Class B-3 (IOM Members)		
Last New CME Bundled Unit Sale	11/14/01	\$375,000
First CME Holdings Class B-3 Bundled Unit Sale	12/14/01	\$365,000
First CME Holdings Class B-3 B Share Unit Sale	12/20/01	\$246,000
Class B-4 (GEM Members)		
Last New CME Series B-4 Sale	11/30/01	\$23,000
First CME Holdings Class B-4 Bundled Unit Sale	12/31/02	\$21,500
First CME Holdings Class B-4 Share Unit Sale	01/09/02	\$25,000

* Disregards an unrepresentative matched bid and offer sale.